May 21, 1998

Honorable John McCain
Chairman
Committee on Commerce, Science,
  and Transportation
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter provides a preliminary estimate of S. 1415, the National Tobacco Policy and Youth Smoking Reduction Act, currently under consideration by the Senate. This estimate is based on the manager's amendment offered by Majority Leader Lott, which modified the Commerce Committee substitute amendment by incorporating some Finance Committee amendments and adding Senator Lugar's amendment relating to tobacco farmers. CBO has not had time to analyze thoroughly the revised legislative language, but we are able to provide a broad outline of the effect that the legislation would have on federal revenues and spending and of the state and local and private sector mandates contained in the legislation.

The legislation would require tobacco manufacturers and importers to make annual payments to the federal government and to pay additional penalties if smoking by youth does not fall below specified levels. In a May 19 letter, the Joint Committee on Taxation estimated that net federal revenues would increase by $15 billion in 1999 and by $65 billion over the 1999-2003 period if the legislation is enacted (see the attached table). CBO estimates that direct spending under the bill would increase by $8 billion in 1999 and $42 billion over the 1999-2003 period. CBO further estimates that if the amounts authorized to be appropriated from the National Tobacco Trust Fund were appropriated each year, discretionary spending would increase by $2 billion in 1999 and $23 billion over the 1999-2003 period.

An amount equal to the estimated increase in net federal revenues would be credited to a new National Tobacco Trust Fund. The legislation establishes four expenditure accounts within that trust fund and allocates amounts credited to the trust fund among those accounts as follows:

- a State Litigation Settlement Account—40 percent of the annual payments credited to the trust fund;

- a Public Health Allocation Account—22 percent of the annual payments plus all of the youth penalties;

- a Health and Health-Related Research Allocation Account—22 percent of the annual payments; and

- a Farmers Assistance Allocation Account—16 percent of the annual payments through 2008 and 4 percent thereafter.

In addition, a Medicare Preservation Account is established in the trust fund. The excess of the general industry payments credited to the National Tobacco Trust Fund above the total increase in net revenues originally estimated to result from this legislation, and, after 2008, 12 percent of the total amount credited to the trust fund, would be allocated to the Medicare account and transferred to Medicare's Hospital Insurance Trust Fund.

The legislation provides that amounts allocated to the State Litigation Settlement Account and the Farmers Assistance Allocation Account would be available as direct spending for the purposes specified. Amounts allocated to the Public Health Allocation Account and the Health and Health-Related Research Allocation Account would be available to fund discretionary spending for a variety of specified activities, subject to annual appropriations action. The amounts allocated to the Medicare Preservation Account and transferred to the Hospital Insurance Trust Fund would not affect direct or discretionary spending for Medicare or for any other purpose.

The legislation would also provide additional direct spending and would authorize additional discretionary spending that would not be funded out of the trust fund.

DIRECT SPENDING

The amounts allocated to the State Litigation Settlement Account would be automatically appropriated and available for grants to the states. The legislation requires the Secretary of Treasury to consult with organizations representing states and report to the Congress within 90 days of enactment with recommendations for a formula to distribute the available amounts among the states. The legislation provides that not more than 50 percent of the funds received by a state may be used for any purpose the state chooses and not less than 50 percent must be used to carry out additional activities or provide additional services under the State Children's Health Insurance Program, the maternal and child health block grant, or other specified programs. CBO assumes that the full amount allocated to the account will be obligated to the states each year. Outlays are estimated based on the range of alternative uses allowed for the grants.

The amounts allocated to the Farmers Assistance Allocation Account would also be automatically appropriated and available for obligation. However, the pending legislation contains two separate and contradictory sets of instructions about how the funds are to be used to help cushion the effects of reduced consumption of tobacco products on tobacco farmers (see Titles X and XV). For purposes of this estimate, CBO assumed that the amounts allocated to the account each year would be fully obligated and expended in that year.

The legislation would prohibit the sale of cigarettes in vending machines and provides for paying the owners of cigarette vending machines (other than machines that could be used for other products) an amount equal to the fair-market value of the machines before the prohibition. The legislation states that such payments would be subject to appropriation, but other provisions make it likely that the government would be required to make the promised payments even if discretionary appropriations are not provided.

A number of other provisions would also affect direct spending. Some of these provisions would require Medicare to pay for a demonstration project of cancer care, Medicaid to cover tobacco cessation products, and health insurance plans to cover stays in the hospital related to the treatment of breast cancer. In addition, the bill would prohibit the federal government from recovering any of the payments made to states under this legislation as overpayments of Medicaid costs to the states. Because CBO assumed that the government would recover a portion of funds recovered by states in litigation that would go forward in the absence of this legislation, this provision would reduce expected recoveries and increase net federal spending.

DISCRETIONARY SPENDING

The spending from the Public Health Allocation and the Health-Related Research Allocation accounts would be discretionary. The legislation authorizes appropriations from these two accounts for a broad range of activities, including those dealing with smoking cessation, smoking prevention and education, counter-advertising, and research carried out or sponsored by the National Institutes of Health, the National Science Foundation, and the Centers for Disease Control. CBO has estimated the outlays that would result if appropriations are enacted at the levels authorized from these two accounts. In addition, various other authorizations of appropriations could be funded out of the general fund.

BUDGETARY TREATMENT

The legislation includes a provision that deals with the application of the budget enforcement procedures of the Balanced Budget and Emergency Deficit Control Act of 1985. That provision would exclude from the statutory caps the costs of discretionary appropriations provided pursuant to authorizations in this legislation, thereby increasing the total amount of discretionary spending allowed each year through 2002. The provision states that the increase in net receipts resulting from this legislation that is in excess of the amount needed to offset the increase in direct spending resulting from the legislation "shall be available exclusively to offset the appropriations required to fund the authorizations of appropriations in this Act." The intent of the provision may be to exclude those excess revenues from the pay-as-you-go procedures and to limit the appropriations that are excluded from the caps to the amount of the excess revenues, but the provision does not clearly accomplish that goal.

STATE AND LOCAL MANDATES

The bill would impose a number of mandates on state, local, and tribal governments. The intergovernmental mandate with the most significant potential cost is the preemption of state, local, and tribal ability to pursue certain tobacco claims based on health-related effects of tobacco. States could opt out of this prohibition if they had a tobacco claim pending, but they would thereby relinquish claims to trust fund payments. Local and tribal governments would not be able to opt out of the prohibition, and they would not directly share in payments from the trust fund. Furthermore, neither they nor a state would be able to file a new tobacco claim after this bill's enactment. The net costs of this mandate would equal any lost revenues from foregone legal claims less payments to states from the trust fund. Because the outcomes of pending or potential lawsuits cannot be precisely estimated, CBO cannot determine whether the net costs of this mandate would exceed the threshold for intergovernmental mandate costs as established by the Unfunded Mandates Reform Act of 1995.

PRIVATE-SECTOR MANDATES

The bill would also impose a number of significant mandates on the private sector, particularly on manufacturers of tobacco products. Five major manufacturers would be required to make an initial payment into the National Tobacco Trust Fund totaling $10 billion. In addition, all manufacturers of tobacco products would be required to make payments in each year following enactment, with the payments in the first year totaling over $14 billion. They would also be subject to additional assessments in the third and subsequent years after enactment if the percentage of teenagers who smoke did not decline by specified amounts. The bill would impose a number of other mandates on tobacco product manufacturers, distributors, retailers, importers, and other private sector entities. Those mandates include limitations on advertising and sales, requirements for licensing and labeling, and restrictions on indoor smoking. In total, the direct cost of the mandates in the bill would significantly exceed the threshold for private-sector mandate costs as established by the Unfunded Mandates Reform Act of 1995.

Sincerely,

June E. O'Neill
Director

Attachment

cc: Honorable Ernest F. Hollings
Ranking Democrat

Honorable Pete V. Domenici
Chairman, Senate Committee on the Budget

Honorable Frank R. Lautenberg
Ranking Minority Member, Senate Committee on the Budget

Estimated Budgetary Impact of S. 1415

	By fiscal year, in billions of dollars										
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
CHANGES IN REVENUES											
General Industry Payments	0	15	11	13	13	13	14	14	15	15	16
Look-back Assessment	0	0	0	0	0	0	1	1	4	3	3
Total [a]	0	15	11	13	13	13	15	15	19	19	19
DIRECT SPENDING OUTLAYS											
Out of National Tobacco Settlement Trust Fund											
State litigation settlement account	0	5	5	5	5	5	5	6	6	6	6
Farmers assistance allocation account	0	2	2	2	2	2	2	2	2	2	3
Subtotal	0	7	6	7	7	7	8	8	8	9	9
Compensation of Vending Machine Owners	0	0	1	1	1	0	0	0	0	0	0
Other Direct Spending	0	1	1	1	1	1	1	1	1	1	1
Total Direct Spending	0	8	8	9	9	8	9	9	9	10	10
DISCRETIONARY OUTLAYS [b]											
Public Health Allocation Account	0	1	2	3	3	3	3	4	5	6	7
Health and Health-Related Research Allocation Account	0	1	2	3	3	3	3	3	3	3	3
Total	0	2	5	5	5	6	6	7	8	10	10

SOURCES: Joint Committee on Taxation (May 19, 1998), Congressional Budget Office (May 21, 1998).
NOTE: Numbers may not add to totals because of rounding.

a. The total includes other small changes in revenues not shown separately.
b. CBO estimates these outlays based on the assumption that the full amounts authorized to be appropriated from the National Tobacco Trust Fund would be appropriated each fiscal year. CBO has not yet estimated the total amounts authorized to be appropriated under the bill.